



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

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Significant Index Numbers:

4941.04-00

507.00-00

Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

Legend:

A =

B =

C =

D =

E =

F =

G =

H =

I =

J =

K =

L =

M =

Dear :

We have considered your ruling request dated April 13, 2006, as to the proper treatment of the termination of A and whether termination constitutes an act of self-dealing under section 4941 of the Internal Revenue Code ("Code").

B and C established A as a charitable remainder unitrust described in section 664(d)(3) of the Code, and a split interest trust under section 4947(a)(2). The trust agreement provides that the annual "unitrust amount" that B and C receive shall equal the smaller of: (a) the trust income for any taxable year as defined in section 643(b); and (b) a "fixed percentage" of five percent of the net fair market value of the trust assets. In addition, the trust provides that A and B are to receive any amount of trust income for such year that is in excess of five percent, but only to the extent that the aggregate of the amounts paid in prior years was less than the aggregate of the amounts computed as the fixed percentage of the net fair market value of the trust assets on the relevant valuation dates (the "net income make-up feature").

The trust agreement provides that payments will be made until the death of the surviving spouse. After the death of the surviving spouse, payments are to be made in equal shares to

their two sons, D and E, until the death of the survivor of them. After the death of all four persons, the remainder is to be paid to F, an organization recognized as tax-exempt under section 501(c)(3) of the Code.

B, D and E executed agreements transferring their interests to C. C wishes to terminate A by selling her income interest in A to the charitable remainderman, F, for an amount equal to the present value of the interest of each party in the corpus as it now stands. You have represented that the actuarial values of the respective interests will be calculated using the discount rate in effect at the date of sale under section 7520 of the Code, and the methodology for valuing interests in charitable remainder trusts contained in section 1.664-4 of the Income Tax Regulations ("regulations").

A's state law permits early termination of the trust. At the time the purchase of the income interest is completed, F will hold both the income and remainder interests. F will also be a trustee. Upon purchase of the income interest, F will be advised to file a petition with the probate court seeking a judicial determination that all interests in the trust have merged and that the trust may be terminated and distributed to F.

B was born on G. B is represented as having a health condition creating a shorter than normal life expectancy.

C was born on H. C is represented as having good health and no reason to expect a less than normal life expectancy.

D and E were born on I and J, respectively. Both D and E represent that they are in good health and have no reason to expect a decrease in their life expectancies.

After discussions with our office, A submitted a letter on December 12, 2007 agreeing to the Service's methodology for determining the value of the unitrust interests.

RULINGS REQUESTED:

(1) Early termination of A will not constitute an act of self-dealing under section 4941(a)(2) of the Code by C as trustee or as donor with respect to A using the methodology described above for the date of termination.

(2) Early termination of A will not be subject to a termination tax under section 507 of the Code.

LAW:

Section 507(a)(1) of the Code provides in part, that the status of private foundation shall be terminated if the entity provides notice to the Internal Revenue Service that it is terminating its private foundation status and pays the termination tax under section 507(c).

Section 507(c) of the Code imposes a tax on a private foundation under certain circumstances.

Section 664 of the Code exempts from income tax charitable remainder unitrusts, which it defines as those from which a fixed percentage of the net fair market value of its assets is paid to at least one person not an organization described in section 170(c) for a term of years, after which the remainder interest is transferred to an organization described in section 170(c).

Section 4941(a)(1) of the Code imposes an excise tax on disqualified persons for each act of self-dealing between a disqualified person and a private foundation.

Section 4941(d)(1) of the Code defines self-dealing as including any direct or indirect:

- (A) sale or exchange, or leasing of property between a private foundation and a disqualified person, or
- (E) transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation.

Section 4946(a)(1) of the Code provides that for purposes of this subchapter, the term "disqualified person" means, with respect to a private foundation, a person who is—

- (A) a substantial contributor to the foundation,
- (B) a foundation manager (within the meaning of section (b)(1).

Section 4946(a)(2) of the Code provides that for purposes of paragraph (1), the term "substantial contributor" means a person who is described in section 507(d)(2).

Section 4946(b) of the Code provides that for purposes of this subchapter, the term "foundation manager" means, with respect to any private foundation:

- (1) an officer, director, or trustee of a foundation (or an individual having powers or responsibilities similar to those of officers, directors, or trustees of the foundation, and
- (2) with respect to any act (or failure to act), the employees of the foundation having authority or responsibility with respect to such act (or failure to act).

Section 4947(a)(2) of the Code provides, in pertinent part, that in the case of a trust which is not exempt from tax under section 501(a), not all of the unexpired interests of which are devoted to charitable purposes, and which has amounts in trust for which a charitable deduction was allowed, sections 507 and 4941 apply as if such trust were a private foundation.

Section 4947(a)(2)(A) of the Code provides that section 4947(a)(2) shall not apply with respect to any amounts payable under the terms of such trust to non-charitable income beneficiaries.

Section 53.4947-1(c)(2)(ii) of the Foundation and Similar Excise Taxes Regulations ("foundation regulations") provides, in essence, that payments of income by a charitable remainder unitrust to its individual income beneficiaries do not result in any tax on self-dealing under section 4947.

Section 1.7520-3(b)(1)(ii) of the regulations provides that the standard 7520 annuity, life estate, or remainder factor may not be used to value a restricted beneficial interest. However, a special factor may be used to value a restricted beneficial interest in some circumstances. Section 1.7520-3(b)(1)(i)(C) provides that the standard factor for an ordinary remainder interest represents the present worth of the right to receive \$1.00 at the end of a defined period. Section 1.7520-3(b)(1)(i)(B) provides that the standard factor for an ordinary life estate interest represents the right to receive the use of \$1.00 for a defined period..

ANALYSIS:

A is a split-interest trust described in section 4947(a)(2) of the Code. By being described in section 4947(a)(2), A is subject to the provisions of sections 507, 4941, and 4945, as if it were a private foundation. The income beneficiary, C, is a disqualified person with respect to A within the meaning of section 4946(a)(1)(A) by virtue of being the settlor of A.

In this case, the charitable remainder beneficiary is a public charity so for purposes of sections 4941 and 4946 of the Code, the income beneficiary is not a disqualified person with respect to the charitable remainder beneficiary.

Section 4941 of the Code applies to certain transactions between private foundations and disqualified persons. By early termination, A will distribute lump sums according to the present value of the income beneficiary, C, and the charitable remainderman equal to actuarial value of their interests in A (taking into account the net-income provisions of the trust), and the distributions are also treated as a constructive sale or exchange between C and the charitable remainderman of the trust. See Rev. Rul. 69-486.

Generally payments to the income beneficiary, C, from A would constitute self-dealing. However, because the distribution to the income beneficiary equals the actuarial value of the income interest, taking into account the net-income provisions of the trust, the exception to self-dealing provided by section 53.4947-1(c)(2)(i) of the foundation regulations applies and the distribution will not be an act of self-dealing. Furthermore, because the charitable remaindermen is a public charity, section 4941 of the Code does not apply to the transaction between the C and E, the charitable remainderman.

We agree with your conclusion that the trust effectively terminated in April of 2006. Accordingly, our valuation is based on that date.

The appropriate calculation of the actuarial value of the income interest of A, taking into account the net-income provisions of the trust, requires the use of a reasonable method for the calculation which does not inappropriately inflate the income beneficiary's interest to the detriment of the charitable remainderman.

In dividing the trust estate between the payout beneficiary and charitable remainderman, our actuarial assumptions must provide for the payment to charity of any amounts which, under the provisions of the trust, are dependent on the happening of events which are not so remote as to be negligible. In recent letters issued by the Service starting in 2007, the Service required a special valuation methodology for the early termination of a NIMCRUT in order to avoid self-dealing. The special methodology was applied in situations where the stated payout percentage was in excess of the section 7520 rate at the time of termination. No such special valuation is presently required in this case because the unitrust payout rate is not in excess of the section 7520 rate for the month of the transaction.

B is represented as having a shorter than average life expectancy. The taxpayer has requested that the computation not reflect survival for him. Although no claim of terminal illness was substantiated directly, such substantiation is not necessary in this case, as the removal of the husband from the class of potential payout recipients cannot adversely affect the amount computed as the charitable interest. The factor for the remainder interest following the remaining three measuring lives is the same as the factor for the remainder interest following all four lives assuming the fourth is terminally ill.

Assuming the termination occurred in April 2006, the trust's payout percentage is 5.6 percent. Based on Table 90CM, interest at 5.6 percent, an unadjusted payout rate of 5.0 percent, and quarterly payments made at the end of each quarter, the present value of the remainder interest in a unitrust which commences at the death of the last to die of three persons ages K, L and M is \$0.15069 for each \$1.00 of the trust estate. The present value of the payout interest in the same unitrust payable until such death is \$1.00 - \$0.15069 or \$0.84931 for each \$1.00 of the trust estate.

In this case, the income beneficiary is not expected to receive more than she would during the full term of the trust under the above-described methodology for valuing her interest in a charitable remainder trust with a net income make-up feature. Further, the applicable state law permits early termination of the trust.

In addition, C's personal physician has conducted a physical examination and has stated under penalties of perjury that he finds no medical condition expected to result in a shorter-than-average longevity (under section 1.72-9 of the regulations); and C has signed a similar statement.

Furthermore, because the effect of the transaction is to vest the income interest and remainder interest in the remainder beneficiary, the trust no longer will be a split-interest trust and section 4947(a)(2) of the Code will no longer apply and section 507 will not apply.

CONCLUSIONS:

Therefore, we rule that:

- (1) Early termination of A will not constitute an act of self-dealing under section 4941(a)(1) or (a)(2) of the Code by C as trustee or as donor with respect to A using the methodology described herein for the date of termination.
- (2) Early termination of A will not be subject a termination tax under section 507 of the Code.

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. Also, we express no opinion as to the tax consequences of the transactions under other provisions of the Code. We specifically express no opinion as to the Federal income or gift tax consequences resulting from the transfer of the interests of B, D, and E in A to C. In particular, we express or imply no opinion on the effect of such transfers on A's qualification under section 664 of the Code.

Pursuant to Power of Attorney on file in this office, a copy of this letter is being sent to A's authorized representative. A copy of this letter should be kept in A's permanent records.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter. You should keep a copy in your permanent records.

Sincerely,

Robert C. Harper, Jr.
Manager, Exempt Organizations
Technical Group 3

Enclosure
Notice 437